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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 416

ROSAMUND UNDERWOOD SMITH WILSON, THOMAS W. SMITH AND FRANK STAPLETON, AS EXECUTORS OF THE ESTATE OF COTHRAN P. SMITH, DECEASED, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 96a–102a)[1] is reported in 154 F. Supp. 341. The opinion of the Court of Appeals (Pet. 13–18) is reported in 257 F. 2d 534.

JURISDICTION

The judgment of the Court of Appeals was entered on July 11, 1958. (Pet. 19). The petition for writ of certiorari was filed on October 3, 1958. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

[1] Record references are to the appendix to taxpayers' brief in the Court of Appeals.

QUESTION PRESENTED

Whether the Court of Appeals correctly affirmed the District Court's determination, on the basis of the undisputed facts and upon motions of both parties for a directed verdict, that a corporate distribution of earnings in redemption of some of the stock held by the controlling stockholder (an estate), for the avowed purpose of providing funds for the payment of estate taxes owed by the distributee-stockholder, was essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Internal Revenue Code of 1939.

STATUTES INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * dividends * * *.
>
> * * * * *
>
> (26 U. S. C. 1952 ed., Sec. 22.)
>
> SEC. 115. DISTRIBUTIONS BY CORPORATIONS.
>
> (a) *Definition of Dividend.*—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

(c) [amended by Section 147, Revenue Act of 1942, c. 619, 56 Stat. 798] *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

* * * * *

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated

after February 28, 1913, shall be treated as a taxable dividend.

* * * * *

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * *

(26 U. S. C. 1952 ed., Sec. 115.)

STATEMENT

The taxpayers are the duly qualified executors of the estate of Cothran P. Smith who died on December 26, 1948. (Pet. 13; R. 3a, 5a.)

Smith was the managing director of the Addis Co., Inc., and at the time of his death he owned 2,480 of the 2,500 shares of outstanding Addis Company stock. (Pet. 13; R. 27a.) The remaining 20 shares were owned by his wife and one of his nephews. (Pet. 13; R. 98a–99a.) In his will, Smith left 15% of his stock to his wife, 15% to his nephew, and the remaining 70% to a residual trust for the benefit of his wife and son. (Pet. 17; R. 89a–91a.)

For estate tax purposes, Smith's stock was valued at $868,000 and his entire estate was valued at approximately $1,025,000. (Pet. 13; R. 5a.) His executors were required to pay estate and inheritance taxes totalling approximately $225,000. (R. 5a.)

In 1949, the Addis Company acquired 200 shares of its stock from the Smith estate for $57,200. (Pet. 13; R. 26a.) The transaction was arranged by the tax-

payers who were acting in a dual capacity as directors of the company and executors of the estate. (Pet. 13; R. 23a, 28a.) Pursuant to a corporate resolution, the 200 shares which the company acquired from the estate were carried on the corporate books as treasury stock. (Pet. 13–14; R. 32a.)

On its income tax return for 1949, the estate treated the above transaction as a liquidation distribution giving rise to a capital gain of $43. However, the Commissioner ruled that the $57,200 received by the estate was essentially equivalent to a dividend and was taxable at ordinary income rates, inasmuch as the company had earnings or profits of approximately $657,000. Taxpayers paid the deficiency determined by the Commissioner and thereafter brought refund suit to recover the total payments of $47,848.80. (Pet. 14; R. 3a–4a.)

At the conclusion of the trial, both sides moved for a directed verdict. (R. 71a, 97a.) The District Court granted the Government's motion and denied that of the taxpayers. (R. 102a.) Accordingly, the District Court dismissed the complaint without submitting the case to the jury, holding that the corporation had redeemed its stock and that the simultaneous distribution of $57,200 to the estate as majority stockholder was essentially equivalent to a dividend under Section 115 (g) of the Internal Revenue Code of 1939. (R. 96a–102a.) In an unanimous opinion, the Court of Appeals affirmed this ruling. (Pet. 13–18.)

ARGUMENT

The decision below is correct, the asserted conflict with other decisions does not exist, and the case has

limited significance since it deals with a problem resolved by subsequent legislation.

1. In their petition, taxpayers now assert for the first time that Section 115 (g) of the 1939 Code, *supra*, pp. 3–4, has no application whatsoever to this case (Pet. 9–10), and that if the section were applicable, it would be unconstitutional as applied to them (Pet. 11). Since these contentions were not urged below, they should not be considered now (*Helvering* v. *Wood*, 309 U. S. 344, 348–349), and in any event, the contentions are clearly without merit.

Contrary to taxpayers' assertions (Pet. 9–10), a distribution in redemption of stock can be taxed as a dividend under the applicable provisions of Section 115 (g), regardless of the fact that the purpose of the distribution was to supply funds for the payment of estate and inheritance taxes levied on the estate of a deceased stockholder. *Flanagan* v. *Helvering*, 116 F. 2d 937 (C. A. D. C.). In 1950, after the distribution in question here had taken place, Congress amended Section 115 (g) by stating that "The provisions of this subsection shall not apply" to distributions used to pay estate taxes under certain limited and specified circumstances. Sec. 209 (a), Revenue Act of 1950, c. 994, 64 Stat. 906. This amendment is clearly a relief measure which changes the pre-existing law rather than restating it as suggested by the taxpayers. See S. Rep. No. 2375, 81st Cong., 2d Sess. pp. 82–83 (1950–2 Cum. Bull. 483, 542); H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 90–91 (1950–2 Cum. Bull. 380, 445). See also Sections 302 and 303 of the Internal Revenue Code of 1954.

Taxpayers' argument that the application of Section 115 (g) is unconstitutional as applied to them appears to be based solely on the fact that they are required by the taxing statute to pay a higher tax than they would like. (See Pet. 10–11.)[2] The fact that a particular tax works a hardship clearly does not mean that the tax is unconstitutional. *McCray* v. *United States,* 195 U. S. 27, 57–58, 60–61.

2. Taxpayers' remaining argument, which was urged below, relates to the fact that the District Court decided this case without submitting it to the jury. (See Pet. 5–9.) Various criteria have been suggested as guides in determining whether or not a distribution in redemption is essentially equivalent to a dividend. See, e. g., *Earle* v. *Woodlaw,* 245 F. 2d 119, 126 (C. A. 9th), certiorari denied, 354 U. S. 942. While taxpayers are correct in pointing out (Pet. 5–8) that a number of courts have described dividend equivalence as a question of fact, these cases necessarily presuppose that under the governing criteria, the fact-finder would be warranted in finding for either party. See, *e. g., United States* v. *Fewell,* 255 F. 2d 496, 499–501 (C. A. 5th). The present case is not in conflict with

[2] There is no basis in the statute or elsewhere for taxpayers' suggestion (Pet. 9–10) that, because stock in a "listed corporation" is more readily saleable than that of an unlisted corporation, a distribution of earnings by the latter which is essentially equivalent to a taxable dividend under Section 115 (g) is to be treated as if it were a sale of the stock resulting in capital gain under Section 117. The provisions of Section 115 (g) apply equally to all corporations, whether or not their shares are listed on an Exchange, and the courts below properly applied the same dividend equivalence test here as is applicable to any corporation.

those decisions because the operative facts here are undisputed, and under any of the recognized criteria for deciding the question, the taxpayers could not prevail.

The undisputed facts show that the redemption produced no significant change in the proportionate stock interest of the shareholders. (Pet. 17.) The distribution was not incident to any business contraction (Pet. 17; R. 39a), nor was there any other business purpose for the distribution. The distribution was admittedly arranged by the executors of the shareholder estate for the sole purpose of obtaining funds to pay the taxes which the estate owed. (Pet. 4.) Despite substantial profits, the corporation had declared no dividends on its common stock during the six-year period prior to this distribution. (Pet. 18; R. 50a–51a.) At the time of the $57,200 distribution, the corporation had earnings or profits of some $657,000. (R. 38a.)

On this set of facts, the District Court was clearly correct in deciding the issue. (R. 73a–88a, 96a–98a.) *Commissioner* v. *Roberts,* 203 F. 2d 304, 306 (C. A. 4th); *Earle* v. *Woodlaw,* 245 F. 2d 119, 126–130 (C. A. 9th), certiorari denied, 354 U. S. 942. See *Ferro* v. *Commissioner,* 242 F. 2d 838, 841–842 (C. A. 3d). Cf. *Keefe* v. *Cote,* 213 F. 2d 651, 656–657 (C. A. 1st); *United States* v. *Fewell,* 255 F. 2d 496, 499–501 (C. A. 5th); *Jones* v. *Griffin,* 216 F. 2d 885, 887, 890 (C. A. 10th). By moving for a directed verdict, as did the Government, taxpayers recognized and claimed that no issue of fact remained for submission to the jury.

3. No claim is or can be made that the courts below failed to apply the judicially established legal stand-

ards for determining the question of dividend equivalence under Section 115 (g) of the 1939 Code. Whether the question be viewed as one of law, or of ultimate fact, or as a mixed question of law and fact, is of academic importance insofar as the disposition of this case is concerned, for the result must be the same under either view.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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